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SUBJECT: MADRID WEEKLY ECON/AG/COMMERCIAL UPDATE REPORT -  
JUNE 18

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ECON: Weakening Spanish Economy  
ECON: GoS to have Budget surplus for the 4th year  
EINV/EFIN: Spain's big banks selling off real estate and debt  
EAIR: Spanair for sale  
ENRG: Miscalculation causes debate over electricity prices  
EAGR: Olive production hits record highs  
SOCI: Madrid makes top 30 most expensive city list  
ECON: Taxes in Spain

THE STAGE IS SET FOR THE BEGINNING OF THE END OF THE ECONOMIC  
BOOM

11. (U) Andrew Garthwaite, Chief Global Equity Strategist, summarized local opinion in an editorial about the weakening Spanish Economy. Garthwaite believes that Spain's economic boom was caused by the ECB interest rate being too low for Spain's unique economic circumstances. Garthwaite believes that as interest rates trend upward this will have a negative effect on consumers who have 75% of their debt at floating rates.

12. (U) Garthwaite further points out a number of potential weaknesses in the Spanish economy. First, both businesses and Spanish consumers have too much debt. Second, the ratio of housing prices to wages is too high implying that housing is overvalued. Third, too much of the Spanish economy (20% of total, and 33% of growth) is dependent upon in the real estate sector. Spain is also losing its competitiveness in labor due to growing unit labor costs relative to other EU countries. Finally, Spain's stock market appears overvalued, including the blue-chip IBEX index.

13. (U) Despite these warning signs, Garthwaite believes that with government debt being relatively low at 21% of GDP, and continuing immigration, Spain should have the flexibility to adjust smoothly to the end of its boom and avoid recession. (Note: Most Embassy contacts in the private sector continue bullish on the economy has been overwhelmingly optimistic. Despite the obvious existence of "weaknesses" and the weakening housing market, our contacts tell us that the Spanish economy will avoid serious negative repercussions. (June 14, Financial Times)

BUDGET SURPLUS DESPITE TAX INCREASE

14. (U) The GoS reports that tax revenues in Spain are expected to rise by 7% next year and will lead to a budget surplus for the fourth consecutive year. Despite this optimistic news, the government reports that it wishes to

continue to be prudent on fiscal matters and maintain a balanced budget. GoS officials are concerned that increases in social security costs and other social spending will stress the spending side of the ledger. The European Commission indicates that Spain will see a budget surplus of 1.4% of GDP in 2007, a much more optimistic prediction than GoS' 7% estimate.

#### SPAIN'S BIG BANKS SELLING OFF REAL ESTATE AND DEBT

15. (U) Following a trend among large banks, Bank of Santander has decided to sell off nearly all of its real estate, mostly company offices. In what will be the largest real estate sale ever in Spain, Bank of Santander expects to make a profit of about 1.4 billion euros on properties worth an estimated 4 billion euros. (Comment. Presumably to help pay for proposed acquisition of Banco Real of Brazil and Banca Antonveneta of Italy.) In a similar move, BBVA announced that they decided to sell most of its offices in Bilbao and Madrid in an effort to relocate its various offices to a centrally located headquarters in Madrid.

16. (U) In other news, BBVA has decided to auction off 720 million euros of delinquent debt in order to increase liquidity as well as escape an anticipated rise in delinquent debt in Spain. This follows a 2005 Banco Santander move to sell off a Spanish record 1.4 billion worth of delinquent accounts. Banks are also considering selling some of their current mortgage loans, also in anticipation of an increased risk of delinquency of payment in that sector.

#### SPANAIR FOR SALE

17. (U) The Scandinavian airline SAS has announced that it will sell Spanair. Spanair Spain's second biggest airline, has not been profitable under SAS and has generally been problematic for the company. Gonzalo Pascual, the current Spanair Chairman, and also president of Marsans said that he

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wants to launch a full takeover and will use the funds generated from the recent sale of Marsans' cruise business to Royal Caribbean. Pascual was one of the original founders of the twenty five year old Spanair.

#### DEBATE ON FUTURE ELECTRICITY PRICES

18. (U) Last week, the Ministry of Industry in conjunction with the National Commission on Energy announced a 1.8 percent hike for August. GoS recently discovered that Spanish energy firms had erroneously overcharged clients in 2006 to the tune of 1.1 billion euros (a result of an accounting issue involving emission credits). Energy companies will feel the affect of this miscalculation presumably as the debate on energy prices continues to gain momentum.

#### OLIVE PRODUCTION HITS RECORD HIGH

19. (U) Olive production has reached record levels, according to the Olive Oil Agency in a record harvest. The large supply has pushed down prices domestically and of Spanish exports of olive products.

#### MADRID MAKES THE TOP 30 MOST EXPENSIVE CITIES LIST

110. (U) Madrid and Barcelona are two of the 30 most expensive cities in the world for foreigners employed in a foreign company according to a study from Mercer Human Resource Consulting. Madrid occupied position 53 last year and jumped to 26th place. Barcelona moved up 25 places from last years standings up to 31. The average monthly rent for an unfurnished two bedroom apartment in Madrid is 1,400 and 1,500 euros in Barcelona. Whereas in Moscow, the city that holds the number 1 ranking, average monthly rent is 3,036 euros. The reason for this showing is attributed to the

strength of the euro and other European currencies that have caused European cities, not only in Spain, to have scaled positions.

#### TAXES IN SPAIN

¶11. (U) In 2006 Spain's tax percentage climbed to 36.52% of GDP, although it still remains below the EU average of 41.2%.

This figure has been rising at about 1% per year throughout Zapatero's term and is a product of Spain's economic boom and reduction in unemployment. Although this economic indicator gives no evidence of an economic slowdown, it is considered too early for the effects of a slowdown to have shown up in Spain's tax revenues.

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